

# Examiner's report

## F6 (MWI) Taxation

December 2016

### General Comments

There were two sections to the examination paper and all of the questions were compulsory. Section A consisted of 15 multiple choice questions of two marks each which covered a broad range of syllabus topics. Section B had six questions, four worth 10 marks each and two longer questions worth 15 marks, each testing the candidates' understanding and application of tax. The following paragraphs report on each section and focus on some of the key learning points.

### Specific Comments

#### Section A

Most candidates attempted all of the questions in this section. Candidates are advised to answer all of the questions in this section as this increases their chances of doing well in this paper. Candidates preparing for future examinations in this paper should ensure that they have covered all the aspects of the syllabus as Section A questions aim to test a broad coverage of the syllabus. Candidates are advised to carefully read the question and obtain an understanding of the problem before attempting to answer the questions. The following question is reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with exam questions and to provide a technical debrief on the topics covered by the specific question selected.

#### Question 13

David is employed by ABC Limited for a salary of K1,500,000 per month. ABC Limited provides David with rent free unfurnished accommodation in a house owned by the company, which is within its business premises. The rent for a similar house is K200,000 per month.

**What is the value per quarter of the accommodation provided to David for fringe benefits tax purposes?**

- A K450,000
- B K300,000
- C K600,000
- D K0

This question tested the candidate's ability to calculate the value for fringe benefits tax, where a company provides housing to its staff. In this particular the house is located on company premises. The question requested candidates to work out the value of this benefit per quarter.

The key to passing this question was first to recognise that the benefit is for a house owned by a company located on its own premises. Therefore, in addition to the normal rules for FBT, the value would be reduced.

The normal rule for unfurnished accommodation is that the value for FBT is the higher of 10% of salary or actual rental. In this case the 10% of salary works out at K150,000 per month, whilst the rental value is K200,000 per month. This converts to K450,000 per quarter or K600,000 per quarter respectively. In this case as the house is owned by the employer the value of rental for FBT purposes is taken as 50% of the rental.

The correct answer is A K450,000. This answer takes into account that 10% of the salary is higher than the actual rental of K0. It should be noted that the employer does not actually pay any rental for the house since it's owned by the employer. In this case, what is important is the salary. However, even if we had to compare with

market value rental the 10% of salary would be higher as the market value rental would be reduced by 50 % in this case the rental value is K300,000.

Answer B K300,000. This is the market value rental reduced by 50% as the house is owned by the employer. This ignores the comparison to the 10% of the salary for the quarter,

Answer C K600,000. This is the value for FBT worked out as the market rental value for the house for the quarter. The monthly value is K200,000 and this is higher than the 10% of salary of K150,000. The house rent is K200,000 per month, therefore for the quarter should be K600,000.

Answer D K0. This is on the basis that as the house is owned by the employer and that no physical cash is paid out for the rental. Then it makes sense that the value of the benefit is zero as there is no cost to the employer.

## **Section B**

### **Question One**

This was a 10-mark question which dealt with the principles of Value Added Tax (VAT) with regard to claiming of input and charging of output tax for a clothing manufacturer who makes both zero rated and taxable supplies.

Part (a) for 3 marks required candidates to explain the circumstances under which pre-registration input is claimed. Performance in this part was generally satisfactory. However, there were some candidates who did not mention that to be claimed, the input VAT must have been in respect of expenditure on goods and capital goods and that these must have been there at the date of registration. Most candidates mentioned that the goods must have been purchased not more than four months before and, in case of capital goods, six months before registration. However, some candidates did not mention the distinction between the two.

Part (b) for 7 marks required candidates to calculate the VAT which was claimable by Dekani Limit for the month of April 2016. This part was generally well answered. For candidates who did not perform well in this part, it was mainly because any split between exempt and taxable was not shown. With regard to rent arrears, as this related to a period before registration, the VAT was not claimable. Some candidates charged VAT on a passenger vehicle which was not the case in this question. Further some candidates did not claim VAT on goods bought four months before registration and also on the machinery.

### **Question Two**

This 10 mark question was in two parts and was in respect of taxation of farming activities.

Part (a) was for 3 marks this required candidates to state how the taxable income of a farmer involved in the growing of timber is determined. This part of the question was dealt with correctly with a majority of candidates stating that the farmer can make an election on how the income is arrived at. That costs can be carried forward including the fixed percentage of 5% of the costs until the timber has matured.

Part (b) was for 7 marks and required candidates to calculate John Mafuta's taxable income for the year ended 30 June 2016. Generally this part was not well answered. With regard to the carrying of costs until the timber reached maturity, most candidates did not calculate the years from each expenditure period to the year when the timber was sold. Candidates should have calculated the period and multiply the 5% additional cost for each period by the number of years to arrive at the total additional cost. After this the result would be added to the growing costs to arrive at the total cost. All the costs for all the years would then be added to arrive at the total cost. The costs for the harvested timber would then be a proportion of the total cost harvested compared to the total area of the timber grown. The result would be subtracted from the total income. However the adjustment for the other expenses was properly handled by the candidates and deducted from the total of farming income for the year.

### Question Three

This was a 10-mark question dealing with the taxation of individual's income including income from employment. Part (a) for 2 marks required candidates to calculate PAYE from Peter's employment package that he was offered at Black Limited for the year ended 30 June 2016. This part was generally well answered. This involved candidates, in taking total income from employment and, calculating the PAYE that would have been deducted by the employer.

Most candidates correctly identified the income being his salary, gratuity and bonus (in this case the bonus was '0'). Some candidates however wrongly included the income from employment of the wife as if it would be taxed on Peter. Some did not list all the items eligible as per instructions, even though the amount involved was zero.

(b) For 8 marks candidates were required to compute the taxable income of both Peter and Nelia for the year ended 30 June 2016. The performance in this part was mixed. Some candidates performed very well while other did not get it right. The presentation of answers was an issue. There was duplication of information resulting in candidates wasting time. The columnar form of presentation will save time as descriptive information would only be written once.

Many candidates did not realise that unearned income of the wife is taxed on the husband. In this case unearned income included interest and rental income. The rental income although indicated as received by the wife should have been taxed on the husband Peter.

### Question Four

This 10-mark question dealt with the taxation of capital gains for Nelson Manda an entrepreneur.

Part (a) this was for 5 marks and required candidates calculate the capital gains resulting from the sale of the assets. This part was generally not well answered for two reasons: the first reason is that some candidates did not apply the inflation indices, second for those that applied the indices; they applied the indices for the wrong period. Candidates should note that indices are applied as follows: the index on the date of disposal is divided by the index on the date of purchase. The resulting figure is multiplied by the cost of the asset to arrive at the adjusted basis for capital gains.

Part (b) was for 3 marks this required the candidates to state how the assets which do not result in a capital gain will be treated for tax purposes. This was not well answered.

From the list, the assets that did not result in a capital gain were the warehouse and the motor vehicle. The warehouse attracted capital allowances and any sale whose proceeds of sale exceeded the tax written down value would result in a balancing charge and this would be dealt with through calculation of capital allowances. As for the motor vehicle, since this was personal it was not subject to capital allowances and therefore not subject to capital gains or any charge to income tax.

Part (c) was for 2 marks and required candidates to state the implications if the house that was sold in part (a) had actually been destroyed in a fire and the sale proceeds were insurance proceeds. This was again not well answered. The majority of the candidates jumped to involuntary conversion. If the house was destroyed in a fire and proceeds of insurance received, there would be no change to the capital gain. The only change would be if he decided to replace the house with a similar one, in which case the involuntary conversion provisions would apply. However, if not all of the proceeds were used to buy another house, the gain would be restricted to the excess of the insurance proceeds over the cost of the replacement house.

### Question Five

This question was for 15 marks and involved the calculation of fringe benefits tax and also the taxation of an individual Handiwelo Mutata who is employed as a consultant. The question was in two parts; part (a) was for 5 marks and part (b) for 10 marks.

Part (a) for 5 marks required the candidates to calculate the fringe benefits tax payable for the benefits payable to Handiwelo Mutata for the year ended 30 June 2016. This part was generally well answered. Those that did not score more marks did not fully understand the provisions of Fringe Benefits Tax (FBT). Also in certain cases the presentation was poor, candidates approached this question as a narrative and instead of listing the benefits to arrive at a total value for FBT and then working out total FBT payable. Candidates worked out the tax payable on each benefit, which was not what the question required. For candidates to do well in these types of questions they need to:

- Read and understand the requirements of the question;
- Pay particular attention to presentation to avoid duplication of information and
- Pay particular attention to instructions given in the question

Part (b) was for 10 marks, this required candidates to calculate the tax payable by Handiwelo Mutata for the year ended 30 June 2016, clearly identifying the tax liability and the tax due. The performance for most candidates was satisfactory. Most candidates correctly listed the income that was subject to the income tax computation to arrive at taxable income. Then, applied the tax rates applicable to individuals and, arrived at the tax liability. From the tax liability tax credits were given for PAYE and withholding tax. However some candidates included fringe benefits which were subject to FBT and the tax was not chargeable on Handiwelo. Candidates need to follow the instructions given in the question.

### Question Six

This question was for 15 marks and it involved the computation of tax liability for a company which was involved in the manufacture of agricultural equipment. This question was in two parts

Part (a) for was for 13 marks and required candidates to calculate the tax payable by Mulingo Limited for the year ended 31 December 2015. With only a few exceptions, the performance in this question was good. Generally, most candidates prepared the tax computation to arrive at taxable profits. This involved adding back to profits items which were not allowable for taxation and subtracting items which were included in income but are not taxable.

Candidates correctly followed the instructions in the question that items should be listed, where there was no adjustment required then it should have been indicated with a zero.

The candidates that did not do well were those that did not specifically follow the instructions.

For those who did not do well the following mistakes were made:

- Not properly considering items which should be allowed or disallowed;
- Not listing all items of expenditure as per question and indicating against the value with a “0” those items that did not require adjustment
- Calculating tax based on rates applicable to individuals
- Not giving tax credits for withholding taxes and provisional tax

It is important that candidates read the questions very carefully to obtain an understanding of what is required.

Part (b) for 2 marks required candidates to explain the effects on tax if Milingo Limited were a branch of a foreign company. This part on the whole as most candidates explained that the applicable tax rate would be at 35%, but did not go as far as explaining that total tax would increase by 5%.